

1 **BEFORE THE INSURANCE COMMISSIONER**
2 **FOR THE STATE OF DELAWARE**

3
4 **In Re: The Proposed Affiliation of)**
5 **BCBSD, INC., doing business as)**
6 **Blue Cross Blue Shield of Delaware)**
7 **with HIGHMARK INC.)**

Docket No.: 1509-10

8
9 **DIRECT TESTIMONY OF FRED EARLEY, A WITNESS CALLED BY**
10 **HIGHMARK INC. AT THE HEARING OF OCTOBER 5-7, 2011**

11 **Q. Please state your full name.**

12 **A.** J. Fred Earley II.

13 **Q. By whom are you employed and in what capacity?**

14 **A.** I am employed by Highmark West Virginia, which does business as Highmark Blue
15 Cross Blue Shield West Virginia. I am the President of the Company.

16 **Q. Describe your duties as President of Highmark West Virginia.**

17 **A.** I have overall responsibility for all West Virginia market functions, including sales and
18 marketing, provider reimbursement and relations, government relations, public relations,
19 and regulatory affairs. I also serve as a member of the Board of Directors for Highmark
20 West Virginia.

21 **Q. What is your education?**

22 **A.** I have a Bachelor of Science degree in Business Administration from West Virginia
23 University and a Law degree from The Washington and Lee University School of Law.

EXHIBIT
JOINT-11

24 **Q. Prior to joining Highmark West Virginia, where did you work?**

25 **A.** Prior to joining Highmark West Virginia in 1989, I worked as a Revenue Agent for the
26 Internal Revenue Service, Senior Tax Consultant for Arthur Andersen & Company in
27 Washington, DC, and worked as an attorney for law firms in Washington DC and
28 Parkersburg, West Virginia. Upon joining the predecessor company to Highmark West
29 Virginia, I served as General Counsel and later as Vice President of Managed Care. I was
30 later promoted to Senior Vice President of External Operations; Corporate Compliance
31 Officer; Corporate Secretary and General Counsel, before being appointed President of
32 the company in 2009.

33 **Q. Please describe Highmark West Virginia.**

34 **A.** As West Virginia's largest health insurance carrier, Highmark West Virginia is a non-
35 profit West Virginia health services corporation and operated exclusively under the Blue
36 Cross and Blue Shield service marks. Highmark West Virginia serves all of West
37 Virginia's 55 counties and Washington County, Ohio, and is an independent licensee of
38 the Blue Cross Blue Shield Association and an affiliate of Highmark Inc. The company,
39 headquartered in Parkersburg, has approximately 875 employees with additional offices
40 in Charleston and Wheeling, and provides or administers coverage to more than 585,000
41 individuals. Approximately one-half of the members are inter-plan program, (i.e. Blue
42 Card) enrollment.

43 **Q. Please describe the history of the association between Highmark West Virginia and**
44 **Highmark.**

45 **A.** Blue Cross and Blue Shield of West Central West Virginia (the “Parkersburg Plan”)
46 acquired certain assets pursuant to the liquidation of Blue Cross and Blue Shield of West
47 Virginia (the “Charleston Plan”) which was placed into liquidation by the Offices of the
48 Insurance Commissioner of the State of West Virginia, which I will refer to hereafter as
49 the West Virginia Insurance Commission or Insurance Commission, on October 26,
50 1990. At that time, the name of the Parkersburg Plan was changed to Mountain State
51 Blue Cross Blue Shield (“Mountain State”). In early 1991, a second-tier subsidiary of
52 Medical Mutual of Ohio (formerly Blue Cross and Blue Shield Mutual of Ohio, or
53 BCBSMO) provided capital to Mountain State in the form of a Surplus Loan. BCBSMO,
54 through its CEO, appointed the Board of Directors of Mountain State and various
55 administrative agreements existed between Mountain State and BCBSMO or its affiliates
56 during the relationship.

57 Mountain State was committed to the traditional values of the Blue Cross Blue Shield
58 Association’s system and the service marks it represented. That commitment contributed
59 heavily to our separation from BCBSMO in March 1997. BCBSMO lost its right to
60 utilize the Blue Cross Blue Shield marks in the second quarter of 1997 after a long fight
61 with the Blue Cross Blue Shield Association concerning a proposed transaction with
62 Columbia HCA which ultimately did not materialize. Subsequent to these events,
63 BCBSMO changed its name to Medical Mutual of Ohio.

64 As Mountain State began the process of separation from BCBSMO, the strategy included
65 the resignation of Ohio executives from the Board of Directors; the naming of a new
66 chairman in West Virginia; a change in the corporation's officers and general counsel;
67 and a restructure of the corporate organization. These and other issues were addressed to
68 meet the licensure requirements of the Association and to reaffirm our corporate
69 commitment to maintain the traditional values of a Blue Cross Blue Shield Plan.

70 In 1997, Mountain State solicited affiliation proposals from a number of Blue Cross and
71 Blue Shield plans. Ultimately, Highmark was selected because it met the primary
72 objectives of Mountain State. These objectives were:

- 73 1. Commitment to the non-profit Blue Cross and Blue Shield values.
- 74 2. Commitment to the employees of Mountain State.
- 75 3. Commitment to the State of West Virginia.
- 76 4. Commitment to improving the capital position of Mountain State.

77 The transaction was officially submitted as a Form A filing with the West Virginia
78 Insurance Commission on March 19, 1999. The parties had worked closely with the
79 Insurance Commission to shape a transaction that would be approved.. The transaction
80 called for financing via a Surplus Note, in an amount not to exceed \$10,000,000, to retire
81 the Surplus Note with Medical Mutual of Ohio and to meet the statutory reserve
82 requirement. The Agreement also called for the two Plans to negotiate exclusively for
83 two years for a closer affiliation and transferred the primary Blue Cross Blue Shield
84 Association license for the State of West Virginia from Mountain State to Highmark.
85 The transfer of the primary license and the granting of a Smaller Controlled Affiliate

86 license resulted in Mountain State's minimum capital requirements becoming
87 significantly lower. In conjunction with this, Highmark was required to provide a
88 guaranty of the contractual and financial obligations of Mountain State to its customers in
89 accordance with Association guidelines. The transaction enabled Highmark to establish a
90 governance role in Mountain State by having representation on the Board coupled with
91 super majority-voting requirement for specific corporate actions. Mountain State also
92 agreed to financial and operational benchmarks which, if not met, would allow Highmark
93 to further increase its representation on the Board. The affiliation also resulted in
94 administrative services agreements between the two parties and each agreement reflected
95 economic value to Mountain State. Any administrative agreement entered into was
96 subject to approval by the Insurance Commission. The two parties had executed a Master
97 Service Agreement and numerous agreements which were in place until 2009.

98 On March 4, 2002, the Mountain State Board of Directors unanimously passed a
99 resolution stating that Mountain State had determined it to be in its best interest to
100 develop a closer corporate relationship with Highmark and had agreed to the terms and
101 conditions of a proposed closer relationship, to be evidenced by a formal agreement. A
102 target date of May 2004 was established for the closer relationship to become effective.
103 Mountain State submitted an agreement (the "Agreement") with the Insurance
104 Commission in September 2002 that designated Highmark as the sole corporate member
105 of Mountain State with the authority to appoint and remove members of the Mountain
106 State Board of Directors. In addition, the Agreement set out the framework for
107 implementing the Closer Affiliation. After over a year of review and discussions
108 between Highmark, Mountain State and the Insurance Commission, including a review

109 by its outside counsel, the Insurance Commission requested a public hearing. The public
110 hearing was held on December 4, 2003, in Charleston, West Virginia and the transaction
111 was approved on December 31, 2003. Under the terms of the existing Surplus Note
112 Agreement authorized in the 1999 Approval Order, Mountain State could, at any time
113 after May 13, 2004, request that it be reestablished as the primary licensee of the Blue
114 Cross and Blue Shield marks in the State of West Virginia. The Closer Affiliation Filing
115 provided that Mountain State would no longer have this right, with one exception.
116 Although not contemplated at this time, in the event that the Board of Directors of
117 Highmark determines that it would be in Highmark's best interest to convert from a non-
118 profit to a for-profit corporation, the five independent directors of Mountain State may
119 exercise the right to require that Highmark withdraw as the sole corporate member of
120 Mountain State and re-establish Mountain State as the primary licensee in the state. This
121 right is subject to the approval of the Blue Cross Blue Shield Association and is
122 conditioned on the repayment to Highmark of all surplus note balances, of which there
123 are currently none, and subsidies provided to Mountain State. The terms of this
124 repayment obligation are set forth in the First Amendment to Surplus Note Agreement.
125 On May 1, 2004, Highmark became the sole corporate member of Mountain State. The
126 Company continued to do business as Mountain State; however, the legal name of the
127 entity was changed to Highmark West Virginia Inc. As the sole corporate member of
128 Mountain State, Highmark has the authority to elect all members of the Board of
129 Directors of the Corporation. On May 17, 2004, Mountain State held its initial Board
130 meeting with the newly elected Board members.

131 In March of 2009 Greg Smith, the Plan's C.E.O. and President since 1995, announced his
132 retirement effective July 1, 2009. Mr. Smith has remained Chairperson of the Board of
133 Directors and I was named his replacement by the Mountain State Board in May 2009.
134 Since that time, Highmark West Virginia has worked closely with Highmark to further
135 integrate core functions, and the company's d.b.a. name was officially changed to
136 Highmark Blue Cross Blue Shield West Virginia in January 2011.

137 **Q. Would it be fair to say there were three stages of the affiliation between Highmark**
138 **West Virginia and Highmark?**

139 **A.** Yes. First, in 1999, a Surplus Note Agreement was entered into with Highmark Inc. to
140 allow Mountain State to provide financing to, among other things, pay off its
141 indebtedness to Medical Mutual of Ohio. At that time, Highmark obtained representation
142 on the Mountain State Board of Directors along with certain enumerated super-majority
143 voting requirements. The By-Laws were amended and restated to reflect this change as
144 well as other corporate structure changes relating to the closer affiliation. Highmark
145 became the primary licensee in the state of West Virginia for the Blue Cross Blue Shield
146 Association, with Mountain State being a controlled affiliate.

147 Second, in 2004, Mountain State entered into a Closer Affiliation Agreement which
148 further integrated the two companies, including Highmark being designated the sole
149 corporate member of Mountain State. This Agreement included a Task Order for the
150 BluePRINT Systems Migration (which I will describe in a moment), reporting
151 relationships between the two companies, and set forth cost allocation between the
152 companies.

153 Finally, during 2009, the affiliation of the two companies was further solidified by a
154 restructuring that occurred and integrated operational and finance areas and other support
155 functions from both Highmark West Virginia and Highmark in order to optimize
156 efficiencies and performance levels. Additionally, at this time Highmark and Highmark
157 West Virginia entered into reciprocal Administrative Services Agreements, with the
158 approval of the West Virginia Insurance Commission, to better provide for the
159 framework, and flexibility, needed to maximize efficiencies and streamline workflows
160 between the respective companies.

161 **Q. What is the process for Highmark West Virginia disaffiliating with Highmark?**

162 **A.** In the event Highmark converts to a for-profit corporation, Highmark West Virginia shall
163 have the right, exercisable by vote of its five Independent Directors and subject to certain
164 conditions, to require that Highmark withdraw as the sole corporate member of Highmark
165 West Virginia, and that Highmark West Virginia be reestablished as the primary licensee
166 of the Blue Cross and Blue Shield trademarks in the State of West Virginia.

167 **Q. You mention the BluePRINT Systems Migration a moment ago. Can you tell us**
168 **what the BluePRINT Program is?**

169 **A.** BluePRINT is a terminology used to refer to the claims processing, customer service,
170 membership, enrollment utilization management and related systems developed,
171 maintained and operated by Highmark.

172 **Q. Why was it needed by Highmark West Virginia?**

173 **A.** BluePRINT was necessary for Highmark West Virginia to stay competitive and keep up
174 within a changing environment in order to meet customer demands which were
175 becoming increasingly difficult using our legacy systems.

176 **Q. What were the results of implementing BluePRINT in West Virginia?**

177 **A.** The program exceeded our expectations by:

178 1. Increasing functionality and automation. For example, we became more capable
179 of delivering sophisticated benefit plan designs previously unavailable under our
180 legacy systems.

181 2. Improving operational service, efficiency new product development, and better
182 interaction with customers and providers. For example, our claims throughput
183 rates increased dramatically, as did our capacity to accept claims in an electronic
184 format.

185 3. Minimizing cost of future regulatory compliance by allowing us to take advantage
186 of Highmark's scale and expertise.

187 4. Increasing revenue growth by giving us increased capabilities to meet the
188 demands of an expanding base of customers.

189 **Q. What was the cost for BluePRINT, and what process did the West Virginia**
190 **Insurance Commission follow to approve those costs?**

191 **A.** The cost for the BluePRINT was over \$30 million including internal personnel costs. The
192 Insurance Commission reviewed the cost of the system by means of a Form D filing,
193 which was approved in late 2003.

194 **Q. Describe the regulatory approval process for affiliate transactions between**
195 **Highmark and Highmark West Virginia.**

196 **A.** Various Form D filings have been submitted and approved by the Insurance Commission
197 over the term of affiliation. These were required for certain transactions between the
198 companies involving cost allocations. One such Form D filing was the Administrative
199 Services Agreement between the two companies which governs how Highmark West
200 Virginia compensates Highmark for services rendered. Specifically, it provides that this
201 compensation shall be in an amount equal to the fair and reasonable allocable share of the
202 total cost to Highmark of providing the services. Such costs shall include, without
203 limitation, employee salaries, employee benefits and other direct and indirect
204 administrative costs, including charges for corporate overhead. Highmark West
205 Virginia's allocable share of the cost of the services shall be determined in accordance
206 with Highmark's established cost accounting practices as in effect from time to time.
207 Highmark West Virginia also shall reimburse Highmark for any and all direct third party
208 costs incurred by Highmark for the benefit of Highmark West Virginia.

209 **Q. Are there regular meetings between Highmark West Virginia and the West Virginia**
210 **Commissioner?**

211 **A.** Throughout the duration of our affiliation with Highmark, both Highmark and Highmark
212 West Virginia have maintained an unwavering commitment to open and transparent
213 communication with the Insurance Commission. In furtherance of this commitment, I
214 meet regularly with the Insurance Commission personnel on both a formal and informal
215 basis. Finances (including cost allocation issues) are reviewed annually with the
216 Insurance Commission. Annually, Highmark West Virginia is required to file Forms B &

C under the Insurance Holding Company Systems Act. These filings include disclosure of relationships between all members of the holding company system, as well as disclosure of financial reports and any annual report produced. “Partially as a result of these regular meetings with the Commissioner, no ongoing approvals of Highmark service charges under the Administrative Service Agreement are required.”

Candidly, the success of our affiliation with Highmark and its impact on West Virginia has resulted in our commitment to transparency becoming second nature to us. As the information contained in several exhibits indicates, Highmark West Virginia has experienced exceptional growth in enrollment, gains in efficiency and enhanced financial stability. Measuring back to 2004, the time of our closer affiliation transaction, Highmark West Virginia has seen its overall enrollment grow by one third, its statutory reserves triple and its risk based capital percentage almost double. We have also demonstrated significant gains in operating efficiencies, as reflected in our increase in electronic claims submissions and claims pass through rates. Also, notable is our relocation into our new corporate headquarters in Parkersburg in 2009, by which we were able to combine employees from four separate and outdated offices into one state of the art facility. This development has proven to be a significant factor in continued development in the downtown area of Parkersburg, with a variety of other businesses and property developments having occurred in the last two years in the vicinity of our new headquarters.

Additionally, and perhaps most significantly, our affiliation with Highmark has provided Highmark West Virginia the advantages, economies of scale and access to expertise needed to address the unprecedented challenges and changes associated with health care

reform, while at the same time maintaining an organizational structure designed to be serve the specific needs of the West Virginia market.

Q. How are cost allocation issues between Highmark and Highmark West Virginia addressed with the Insurance Commission?

A. We are required to file annual reports with the Insurance Commission to substantiate that costs allocated to Highmark West Virginia by Highmark are within the parameters established and approved by the Insurance Commission.

Q. What is the process for preparing Highmark West Virginia budgets, business and strategic plans?

A. The Highmark West Virginia budgeting and business/strategic planning processes are now fully integrated into those processes within Highmark. Annual approval of the corporate budget and plan by the Highmark West Virginia Board is required.

Q. How do you communicate with Highmark?

A. The overall communications process for Highmark West Virginia has been integrated within Highmark's Communications area. The various areas of operations within Highmark West Virginia report up into their respective areas within Highmark, with all of Health Services which includes a significant majority of the employees and operations, report into the Health Services areas under Deborah Rice, Executive Vice President Health Services.

Q. What decisions are made locally by Highmark West Virginia?

A. I have overall responsibility for all West Virginia market functions, including sales and marketing, provider reimbursement and relations, government relations, public relations,

and regulatory affairs. I also serve as a member of the Board of Directors for Highmark West Virginia.

Q. How does Highmark West Virginia monitor Highmark service charges?

A. On the fourth work day of the month, the Highmark West Virginia Director of Financial Planning and Analysis, Mark Mazzoni, receives an email with a PDF attachment of the summary of the service charges along with a supporting schedule. Also included in the attachment is the Excel spread sheet of the historical invoicing for Mr. Mazzoni's review. He reviews the information for reasonableness and if he has any questions, he contacts Highmark's Cost Accounting and Reporting Department to get the situation resolved. On the 15th of each month, Mr. Mazzoni sends an email to the Cash Management Department approving the payout of the invoice to Highmark.

Q. If Highmark West Virginia has a dispute with Highmark about a service charge, what is the dispute resolution process?

A. In addition to the process described in the previous question, our ASA Form D filing states that "[Mountain State] reserves the right at any time and from time to time to review and inspect appropriate records of Highmark relating to Highmark's cost of providing the Services and any other amounts due and owing to Highmark as provided herein." The initial step in this process would be for me to place a call to Karen Hanlon, Sr. Vice President Financial Planning and Analysis.

281 **Q. How have stakeholders in West Virginia (policyholders, providers, employees and**
282 **citizens) benefited by the affiliation of Highmark and Highmark West Virginia?**

283 **A.** Highmark West Virginia continues to gain operational efficiencies and increased quality
284 through automation and process improvement due to the integration process. The
285 synergies between Highmark West Virginia and Highmark have leveraged best practices
286 and gained cost efficiencies. Specifically, Highmark West Virginia has gained the ability
287 to offer new products and features of products through more efficient product
288 development, expanded reporting capabilities and management programs for clients.
289 Some of these new capabilities and offerings include a Medicare Advantage product for
290 West Virginia, Hospital Organization tiered benefits, Value Based and consumer choice
291 benefit designs, Blue Branded Dental, Blues on Call Plus, wellness initiatives, Patient
292 Center Medical Home pilots, Radiology, Oncology and Pharmacy Benefit Management
293 Programs.

294 Additionally, Highmark West Virginia has been able to leverage Highmark's electronic
295 portal capabilities for both the employer and employee, while introducing the provider
296 portal, NaviNet, to the provider community.

297 Other organizational/operational integration activities have resulted in the offering of
298 more wellness and care management programs for members and groups. Highmark West
299 Virginia has also gained access to favorable contractual terms by leveraging Highmark
300 relationships for Pharmacy Benefit Administration, care management, informatics, and
301 others. The company continues to see increases in its market share, financial strength and
302 stability, consistency with its procurement processes and is better prepared to maintain a
303 compliant environment.

304 Several economic benefits to the state of West Virginia have also been derived from the
305 Highmark affiliation. First, over 300 jobs were created specifically for services provided
306 to Highmark that paid associated wages in excess of \$9 million annually. Also, the
307 affiliation impacted the local economy in an annual amount in excess of \$21 million, and
308 resulted in local Business and Occupation tax revenues of over \$1 million for the last 6
309 years.

310 **Q. In your opinion, has the affiliation between Highmark West Virginia and Highmark**
311 **been good for the citizens of West Virginia?**

312 **A.** As I believe my responses to the previous questions demonstrate, I can state without any
313 hesitation that the affiliation has been beneficial to our customers and providers, and has
314 provided benefit to the State of West Virginia and its citizens.